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SUBJECT: NIGERIAN NAIRA CLIMBS AGAINST THE US DOLLAR

¶1. Summary: The Nigerian naira has appreciated steadily against the U.S. dollar since September 2007. On October 23, the naira climbed to 118.50 per one dollar; its strongest level since July 2002. Experts suggest the appreciation may continue until the end of January 2008. The stability of the naira, particularly against the dollar, has been a major focus of the Central Bank of Nigeria's (CBN) goal of macro-economic stability. An appreciating naira reduces revenue to states because 85% of government revenue comes from crude oil sold in dollars. End Summary.

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Naira Rising

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¶2. The naira has appreciated steadily against the U.S. dollar since September 2007. The naira reached an apex of 118.50 per dollar on the inter-bank market on October 23, 2007. This was its strongest level in five years since July 2002 when the exchange was 117.

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Why The Appreciation?

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¶3. Opinions vary among market players and experts on why the naira has appreciated so steadily. Some have said the continued appreciation since early July has been due largely to a surge in foreign exchange inflows from portfolio investors buying bonds and equities in the Nigerian capital market.

¶4. Others contend that the naira has been grossly undervalued particularly considering Nigeria's accumulation of huge dollar reserves. Nigeria's foreign reserves at the end of October were \$49 billion. These experts expect that Nigeria's increasing dollar earnings from higher crude oil prices will lead to continued naira appreciation.

¶5. Lastly, still another group argues that the steady appreciation is temporary and unsustainable because of market fundamentals of demand and supply, and national macroeconomic objectives. These experts suggest the appreciation will end in late January 2008 due to the upsurge in foreign investors' interest in the economy, inflows from oil companies; increased spending from Nigerian expats returning to Nigeria for holidays in December; and Nigerian banks seeking about \$7 billion from the capital market.

¶6. The experts all agree that the naira has also been helped by the weak performance of the dollar against other major currencies on the international market. The CBN would have sought the naira's appreciation to compensate for a weaker dollar to maintain the

naira's purchasing power parity.

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The CBN Response

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¶7. The stability of the naira, particularly against the dollar, has been a major focus of the Central Bank of Nigeria's (CBN) goal of macro-economic stability. In a likely response to the steady appreciation, the CBN has unofficially suspended its twice-weekly foreign exchange auction to commercial banks. The CBN's official reason for the suspension was claims of "outrageously low" bids quoted by commercial banks. Embassy sources contend that the CBN is watching the market and will intervene when it is considered necessary to slow the naira's rapid appreciation.

¶8. There are signs in the money market that the CBN is already using tight monetary policy to mop-up cash in the system in an attempt to slow the naira's climb. The CBN has started aggressively reducing the supply cash naira by requesting public institutions, such as the Nigerian National Petroleum Corporation, to transfer their account balances with commercial banks to the CBN, and buying up dollars as part of measures to slow the rapid appreciation. Money-market experts agreed the CBN's action to buy dollars from the forex market and simultaneously mop-up naira in the monetary system was needed because buying the excess dollars alone would have pumped additional naira cash into the economy which was already awash with idle funds, and would have further increased the money supply. However, some experts have told us that the CBN should have issued dollar-denominated treasury bills to increase demand for dollars without creating panic in the naira money-market.

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The Money-Market Response

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¶9. The inter-bank market responded promptly to the CBN's liquidity mop-up with the 7-day Nigeria Inter-bank Offer Rate (NIBOR) interest rate increasing by 3.6% to 10% on October 30 from 6.4% on October 24. The 60-day NIBOR and 90-day NIBOR also increased, though marginally, from 12.13 to 13.21% and from 12.48% to 13.29%, respectively. Analysts predict that rates in the inter-bank market would increase further as some maturing treasury bills impact the system and federal revenue for the month of October are allocated.

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Keeping Naira Stable vs. Less Revenue

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¶10. Since CBN Governor Soludo's management of the CBN began in July 2004, the policy has been focused on keeping the naira stable by maintaining an exchange rate with the dollar that fluctuates only by plus or minus 10%. This policy is due to fears of domestic inflation; however, it prevents the domestic economy from taking advantage of the dollar's international depreciation. The naira holding steady with the depreciating dollar has led to a declining naira value to other major currencies. Embassy bank contacts consider the naira grossly undervalued and that the CBN policy is hurting Nigerian exporters and the potential for growth in the non-oil sector. In addition, tension between the federal government and states may increase over CBN policy. A strong naira reduces GON fiscal revenue and results in less revenue to the States and local government authorities because 85 percent of total national revenue comes from dollar denominated crude-oil earnings.

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